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How Vertical Agricultural Business Integration Will Affect The Livestock Industry

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The livestock industry of the South has virtually been reborn in recent years. Although livestock have long been an important part of your farm economy, they have not always been the most distinguished part. Cotton and rice, sugar and tobacco -- these cash crops were for many years the emblem of your region. It would be as inaccurate as it would be indiscreet for me to disparage the place of those crops even today, but it would be equally inaccurate to fail to acknowledge the real strides made in livestock. Nor need there be any hurt sensitivities between your crop and livestock enterprises, for surely both are contributing immensely to Southern prosperity, and will continue to do so.

I will not take time to recite the statistics of your growth in livestock production -- an advance highlighted by especially great expansion in beef cattle. You know this success story; it has been told many times. Moreover, the point of the story is less in statistics of quantity -- how many more livestock you produce -- than in achievements in quality -- how much better livestock you now produce. Time was, and not long ago, when some Southern farmers could describe their cattle as only "cattle," nothing more. Breed or type had little meaning. Now you have blooded herds of Herefords and Angus and Shorthorn and other breeds, as well as many commercial herds of those breeds and of carefully identified cross-breds.

This progress continues, and a bright feature of it is that it is linked to a similar growth in the local consumption of meat and other livestock products. It reflects a substantial improvement in the diets of Southern people.

The Southern expansion in livestock will continue. This is certain; there can be no question about it. The question of the day concerns not that but rather the form in which expansion will take place. This question is, How will livestock production be organized in the future? Will it be carried on in independent family-size units as in the past, or will it shift into one of the new kind of arrangements known by the broad term of vertical integration?

We have seen recently a fast growth in various forms of vertical integration. It has been most rapid in poultry, but integration now exists in hogs and other livestock. What is it? What is its cause? What is its significance -- and its future?

Vertical integration is a broad term that describes a number of arrangements which hook together one or more stages in the production, marketing and distribution of farm products. It is sometimes achieved through combining several successive operations under a single ownership, as when a meat packer goes into the cattle feeding business. More often it is accomplished through contracts, in which the farmer enters into a contractual agreement with a feed dealer, market agency, or someone else. For this reason vertical integration is frequently referred to as contract farming.

The question of vertical integration in agriculture thus may be viewed as the age-old question of the relation of the farmer to the nonfarm parts of the economy. For the most part, agriculture has preferred to keep itself separate and independent. The banker has usually been no closer than a long arm's reach. The marketing man, the exporter, and others have similarly remained at a distance. Vertical integration in effect brings those agents and the farmer closer together.

The reason these are being brought closer together lies, it seems to me, in the greater demands we are making on agriculture. We are, in fact, expecting more of our total economic system -- more material output, little unemployment, security for disaster and old age, a stable price level (an elusive goal, it appears). We are demanding equally much of agriculture. Consumers are getting more and more exacting as to kind and quality of foods they want. Retailers are going into specification buying so as to achieve that quality. We are trying to even out cyclical and seasonal variations in supply of farm products in defiance of the natural variability in farm production. In these and many other ways we expect so much more of agriculture that we put a strain on our customary ways of doing things.

To make the problem more complicated, galloping new technology requires an increasing proficiency and adaptability in agriculture. Day by day, modern farming is becoming more complex. Before long, a person will need to be a combination of Bernard Baruch, Ernest Lawrence and Luther Burbank to be a successful farmer.

In addition the farmer himself has some ambitions, some goals. He, as much as others, wants a degree of regularity and security in his business, and he would like to be spared some of the high risks inherent in agriculture.

There is another thrust toward integration that is of entirely different nature. It arises in the drive on the part of some nonfarm businesses to expand operations. Integration in broilers, for instance, reflects in large measure the efforts of feed dealers to expand the volume of their feed sales. Broiler integration is in this respect a more or less incidental consequence of competitive relationships in the feed business.

This will, I believe, set the stage for my brief observations. I will make just three points.

The first point is that whether we do or do not accept vertical integration in agriculture may revolve as much on social as on economic considerations. To put it differently, the reason we hear of so much concern regarding it is that it bears on the traditional organization of agriculture, namely, the family farm. The family farm has been the management unit within agriculture, and the farm home and farm family have constituted a basic unit in our society, long revered as a seat of independence, vitality and morality. The family farmer has become a tradition, the idealogic decendant of the English yeoman.

I wish I had time to trace the fascinating history of the successive progress of agriculture from feudalism to family farming, but I don't. I wish I could deal with the social aspects of the present controversy, but I don't have time for that either. I can only suggest to all who are concerned with American agriculture that they give full regard to the social implications of vertically integrated or contractual farming.

My second point relates to my earlier statement that vertical integration may make it possible to meet some of the demands of modern society better than they have been met before. Its growth is in a sense a commentary on how well -- or how badly -- we have been doing things. By the same argument, if we prefer not to use vertical integration, we must find a way to do a better job without it.

Centuries ago, the problem was easy. In primitive society, where tribes merely lived off the land, there was complete vertical integration, because the producer was his own consumer. There was no middleman, banker, or fertilizer salesman; no market and no market price. Life may not have been rich but it was simple.

It was when specialization came into the picture that problems arose. It was found that everyone would be better off if each person accepted specialized duties. Gradually, over many centuries the present highly complex system was reached whereby the farmer is a specialist. He carries on a complicated operation, and he must draw on many others for supplies and services. He must obtain machinery and materials from industrial suppliers; he must get adequate credit of the right kind from lending institutions; he must have technical and management know-how, provided by Experiment Stations and Extension Services and at conferences such as this Southern Farm Forum; he must have a good, efficient marketing system available to him. This is not a "by-your-leave" proposition. Either these services must be effectively provided and made use of in American agriculture as it is now organized, or they will be provided through a new and different organization.

Also, risks must be borne by someone. The Federal Government, through loan, storage and insurance programs, has relieved some risks, and has done so within the framework of the family farm. The willingness of farmers to bear those that remain will have much influence on the growth of contract farming.

Agriculture must also be expected to return an adequate income to its members. Apparently many broiler producers believe that vertical integration offers promise of higher income than they could otherwise achieve. A big reason for success of integrated broiler production was that it was able to draw on farmers who were underemployed. Most of those small farmers had little capital, many had insufficient technical knowledge, and nearly all received only low or moderate incomes. While some broiler producers under contract feel hemmed in by the restrictions under which they operate, others find that the added income more than compensates for disadvantages.

Now vertical integration has appeared in hogs. Feeder-pig and sow-and-pig contracts have especially shown up in areas bordering the Corn Belt. Many hog contracts call for the kinds of improvements that have long been advocated for all hog men: farrowing at regular intervals the year around; producing a meat-type hog; and exercising close control of rations and sanitation.

To repeat, my second point is that contract farming or vertical integration may get its biggest boost if it will accomplish many things that traditional agriculture needs to do but has failed to do.

Finally, my third point: we should be loathe to make general statements about whether vertical integration is good or bad. By the same argument, individual contractors should be mighty careful as to the kind of situation into which they get themselves. Contracts can vary from those that are highly beneficial to the farmer, to those that are repressive indeed. Contracting puts the crucial burden on the contract-making process. Unless the farmer is a better negotiator than farmer, it may often be questioned whether he is likely to be better off under a contract than without one. On the other hand, a well-framed contract can be mutually beneficial. For instance, the meat packing industry has long been plagued by the variability and unpredictability of the supply of livestock for slaughter. It is possible to develop contracts under which the producer of hogs would agree to deliver an approximate number of slaughter hogs of specified weight and type at specified periods in the future. Contracts would likely name prices that would be a certain amount above or below the price on a central market. Contracts of this nature could be set up that would not violate the essential managerial independence of the hog producer.

Let me repeat my general appraisal. To a degree vertical integration arises because certain economic problems have not been solved. Some problems may be relieved by contracting; others are merely transferred to a different arrangement. Whether the new contractual system is regarded as good or bad depends on whether it is worked out in a way that is fair to both parties, and also on how farmers feel about the new conditions compared with the old.

Every observer of trends in vertical integration comes up with his own appraisal as to its future. One reason for differences in opinion is that the future of integration is in no sense predetermined, but rests both on how society judges its social forms, and on how effectively traditional methods solve the economic problems that integration purports to solve.

Vertical integration will certainly come more slowly in livestock than it did in poultry. After all, methods of production in the integrated broiler industry bear a resemblance to factory methods. In them there is a high degree of specialization, and what some call a "simultaneity" of operations, both of which lead to mechanized and high-volume activities. Methods of production in hogs, for instance, do not lend themselves so well to mass procedures. The baby pig cannot be mass produced so readily as can the baby chick. My personal view is that integrated production of hogs similar to that in broilers will increase, but that for some time to come it will not seriously threaten the traditional hog producing industry.

Custom feeding of cattle is a form of vertical integration. In the West, where most feeding is in large commercial feedlots, custom feeding is common. Probably more than half of all cattle fed in California, and nearly half of those in the entire West, are custom fed. Custom feeding is less the rule in the Midwest. Commercial feeding probably will expand, although it is not likely to displace feeding on family farms in the Corn Belt. Custom practices also may become more prevalent.

Beef cattle production, as distinguished from feeding, may be the least susceptible of all livestock to vertical integration. However, contract selling of feeder cattle may increase.

But while vertical integration of the form adopted in broilers may not engulf the livestock industry, modified versions may have more general application. I am thinking of contractual arrangements such as those for marketing of hogs, which I referred to above. These could achieve some of the goals of assuring a predictable supply of livestock for slaughter, of the type desired, without involving the drastic revision of the industry as has occurred for broilers.

Yet even in connection with possible benefits from contract marketing of hogs, may we ask if it is too much to expect the traditional market structure to do as much? Would more selling of hogs, and price reporting, by grade, and more economic outlook information, make it possible to achieve the same ends as would be prescribed under contract?

If integration were to become widespread in livestock the contracting itself would become a focus of attention. Livestock producers would doubtless seek ways to protect their interests in the contract-making procedures. Many persons expect broiler producers to develop some kind of bargaining association. Expanded contracting in livestock might lead to the same trend. Another possibility is that farmer cooperatives would become an agency to protect farmers' interests in contractual arrangements. They might also conduct more of the integrated production or marketing themselves. Cooperatives have long engaged in particular kinds of vertical integration.

In recent years, growth of both contracting and direct marketing has weakened the role of central markets as the setting where prices of livestock are arrived at. If contract production of livestock were to expand greatly, there might be serious question as to whether the price-making structure remained still adequate. Proposals for new institutional form relative to pricing might then be offered.

Widespread vertical integration in livestock could smooth some of current-day problems but not all of them. Vertical integration in broilers has not yet demonstrated, for instance, that it will adjust the volume of production better to market demand, or achieve more stability of production, than was done before. Rather, there is evidence in integrated broiler operations of a tendency toward overexpansion.

There is a danger of another sort in the current interest in vertical integration. Changes of this kind often are greeted most enthusiastically at a time of high prices. Certainly, a hog contract -- almost any hog contract -- will be profitable when fat hogs sell for $18.00, with corn at only $1.05. Producing without contract also will be profitable then. Any hog producer entering into a hog contract now should calculate carefully how well he can make out when hogs sell for considerably less than $18.00. They will do so soon. The 1958 fall pig crop was 17 percent larger than the crop of a year before. Hogs from that crop will begin to move to market in volume in February. Prices will drop to a lower level than in the last couple of years. They will stay lower, for a spring crop 13 percent above the spring crop of 1958 is now in prospect. We do not expect a collapse of hog prices, but the lower level of prices that will come will change the perspective in which to view the contracts now being offered.

Cattle production also is on an increase. Although no official estimate has yet been made, it is certain that the cattle inventory on January 1, 1959 was above that of a year before. The gain was the first following a two-year cyclical decline. Rising production will bring lower prices, but, unlike hogs, cattle do not appear to be in danger of a sharp price decline for another year or two. In cattle feeding, however, where vertical integration is the greater possibility, profit margins are likely to be narrower than in 1958, when they were unusually wide.